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SMEs and access to finance: A vulnerability perspective

Dr Orkun Akseli*

Abstract

This chapter particularly focuses on one of the main implicit effects of the 2008 crisis on the UK financial market that is the shortage of funding for Small and Medium Enterprises (SMEs). The chapter highlights the importance of SMEs in the process of economic recovery in the UK and examines their vulnerable position at this current stage. It investigates the limited access to finance problem from a legal and regulatory perspective and provides an in-depth critical legal analysis of how this problem can be addressed.

1. Introduction

The global financial crisis has highlighted the vulnerability of small businesses¹ in economic downturns, particularly in relation to access to finance. It has become clear that, at such times, the law of credit and security does not enable small businesses to find effective solutions.² This is problematic in light of the role of small businesses in economic growth and social renewal at times of economic crisis. The limited availability and the cost of credit make small businesses vulnerable to market uncertainties caused by financial crisis.³ Finance to small businesses is generally refused on the grounds that they are new to the market, insufficiently profitable or could not provide acceptable collateral. Small businesses present

* Senior Lecturer in Commercial Law, Durham University Law School.

¹ There is no agreed definition of Small and Medium Sized Enterprises (SMEs). The term has been further diversified as small firms, medium sized firms and micro firms. *See below*. Therefore, as an umbrella terminology ‘small businesses’ and ‘SMEs’ will be used interchangeably in this article in order to differentiate them from large firms.

² *See e.g.* ‘Secured Transactions Law: The Case for Reform’, available at <http://securedtransactionsproject.wordpress.com/case-for-reform/> (last visited 20 September 2015). For example in England the secured transactions law regime is restrictive in the sense that unincorporated businesses and SMEs feel they need to incorporate as companies in order to create a charge and access to secured credit.

³ For the effects market liberalisation on development and SMEs *see e.g.* J.A. Ocampo and J.E. Stiglitz (eds), *Capital Market Liberalization and Development* (Oxford: Oxford University Press, 2008).

certain distinctive problems for lenders in terms of lending. These challenges include low capitalisation, small size, varied profitability and growth in the market, problems of information asymmetry and monitoring (difficulties with differentiating the financial position of business from the owner's financial standing), low credit rating, their relatively weak bargaining power, dependency to external finance and credit (which becomes acute at times of recession and financial crisis), and their inability to access financial markets.⁴ Research conducted post 2008 financial crisis has revealed that banks' criterion for lending is based on the size of the firm, which indicates that micro-businesses (0-9 employees) have been most vulnerable to access to finance. Furthermore, it was also pointed out that the demand for and supply of credit during the recession period fell and credit rationing affected 119,000 small businesses where credit was denied.⁵ However, there is a justifiable widespread view that facilitating small businesses' access to finance may support economic growth⁶ and contribute to social mobility and renewal. The failure of small businesses may not only have individual consequences (e.g. personal bankruptcies of employees and members of businesses) but also universal repercussions (e.g. failure of economies and decline in economic growth).

The majority of world trade relies on credit supplied by banks and financial institutions to small businesses. Small businesses account for about 90 per cent of businesses worldwide with 50 per cent of employment around the world⁷ and 58 per cent in the UK by employing 13.5 million people.⁸ However, they experience particular difficulties in raising finance.⁹

⁴ See 'The SME Financing Gap Theory and Evidence volume 1', 17-19 (OECD Publishing, 2006).

⁵ M. Cowling, W. Liu and A. Ledger, 'Small Business Financing in the UK before and during the current financial crisis' (2012) 30 *International Small Business Journal* 778, 794-795.

⁶ See generally e.g. 'SME Access to External Finance' *BIS Economics Paper* No. 16, Department for Business Innovation and Skills (January 2012); T. Beck, A. Demircuc-Kunt and R. Levine, 'SMEs, Growth and Poverty' *the National Bureau of Economic Research Working Paper* 11224 (March 2005); T. Beck, A. Demircuc-Kunt, L. Laeven and R. Levine 'Finance, Firm Size and Growth' *the National Bureau of Economic Research Working Paper* 10983 (December 2004).

⁷ IFC Issue Brief, 'IFC and Small and Medium Sized Enterprises' (2012) http://www.ifc.org/wps/wcm/connect/277d1680486a831abec2ff995bd23db/AM11IFC+IssueBrief_SME.pdf?MOD=AJPERES (last visited September 2015). In the OECD area small businesses account for 99 per cent of all enterprises and employ half of the work force. See 'The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses', (OECD Publishing, 2009), 6.

⁸ Federation of Small Businesses 'The Number Crunching the Credit Crunch' available at <http://www.fsb.org.uk/frontpage/assets/credit%20crunch%20figures.pdf> (last visited on 26 February 2014)

⁹ EU Survey, 'SMEs' Access to Finance' (2013) available at http://ec.europa.eu/enterprise/policies/finance/data/index_en.htm#h2-1 (last visited 27 September 2015); For

Unlike large businesses, they are usually only able to borrow on a secured basis.¹⁰ Yet, they play an important role in securing economic growth and social renewal. From an Ordoliberal perspective, at times of financial crisis, the state must assume its pragmatic duties to ensure that markets achieve their maximum capacity to fulfil their theoretical foundations. This argument suggests that as a political task the state needs to establish and sustain measures for the entrepreneurial cohesion of society. Therefore, the responsibility of the state is to establish a financial and legal framework which understands the barriers to access to finance, and either addresses those barriers or enables small businesses to negotiate them.

Since the 2008 financial crash several national and international policy documents and empirical publications on the effect of financial crisis on small businesses and the pathways to access to finance have been published.¹¹ However, legal doctrinal analysis of small businesses' access to finance from the lens of vulnerability has been sparse.¹² It can be argued that there is a legal theoretical gap that does not allow the conceptualisation of small businesses' vulnerability to financial crisis and market changes and their role in social renewal. Although conceptualising small businesses' vulnerability to market volatilities and

results of surveys taken in 2009, 2011 and August-October 2013 *see* particularly Memo, 'Joint Commission/ ECB Report: Access to Finance and Finding Customers the most pressing problems for SMEs' (Brussels, 14 November 2013).

¹⁰ The Law Commission, 'Company Security Interests A Consultative Report' Consultation Paper No.176, xiv (2004).

¹¹ *E.g.* 'Small Business Survey 2012: SME Employers', Department for Business Innovation and Skills (April 2013); 'SME Access to Finance Schemes – Measures to support SME Growth', Department for Business Innovation and Skills (April 2013); 'The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses', (OECD Publishing, 2009); A. Cosh and A. Hughes, *British Enterprise: Thriving or Surviving?* (ESRC Centre for Business Research, Cambridge, 2007); Department of Business Innovation and Skills 'Results from the 2009 finance survey of SMEs' (2010) <http://www.bis.gov.uk/assets/biscore/enterprise/docs/10-636-2009-finance-survey-smes-results> (last visited 20 September 2015); Business Finance Taskforce, 'Supporting UK Businesses: The report of the UK Business Finance Taskforce' (2010) http://www.bba.org.uk/downloads/bba/Business_Finance_Taskforce_report.pdf (last visited 20 September 2015).

¹² *See e.g.* J. Freedman, 'Small Businesses and the Corporate Form: Burden or Privilege?', 57 *MLR* 555 (1994); M. Hesselink, 'SMEs in European Contract Law' in K. Boele-Woelki and W. Grosheide (eds), *The Future of European Contract Law: Essays in honour of Ewoud Hondius* (Alphen aan den Rijn: Kluwer, 2007), 349; R. J. Mokal, 'Priority as Pathology: The Pari Passu myth' [2001] *Cambridge L. J.* 581, 587 *et seq.*; J. Armour, 'The Law and Economics Debate About Secured Lending: Lessons for European Lawmaking' in H. Eidenmüller and E-M. Kieninger (eds) *The Future of Secured Credit in Europe*, *European Company and Financial Law Review* (Munich: De Gruyter Recht, 2008), 3.

financial crisis would have a significant positive impact on our understanding as to their role in economic growth, the existing legal literature seems to have largely ignored this important aspect of the subject.

In this regards, this chapter particularly focuses on one of the main implicit effects of the 2008 crisis on the UK financial market that is the shortage of funding for Small and Medium Enterprises (SMEs). The chapter highlights the importance of SMEs in the process of economic recovery in the UK and examines their vulnerable position at this current stage. It investigates the limited access to finance problem from a legal and regulatory perspective and provides an in-depth critical legal analysis of how this problem can be addressed. The legal context of access to finance provides an optimal lens through which to explore questions of vulnerability and resilience of small businesses, the role and responsibilities of the State in responding to the risks to which vulnerable businesses are exposed in the aftermath of the financial crisis and the implications of being vulnerable to market volatilities in terms of social renewal.

The chapter begins, by defining the ‘small business’. Then, it continues by examining vulnerability and access to finance. In this context, firstly, vulnerability of small businesses will be discussed. Its philosophical foundations, the significance of small businesses and access to finance and their challenges in this process will be examined. The discussion in this part asks what makes small businesses vulnerable in access to finance; why and how they are vulnerable and the law’s role in making them more resilient. It is argued that the essential starting point must shift from a desire to fund them only at times of crisis to an analysis of why they are vulnerable and why they need to be financed. This will require conceptualisation of vulnerability in the light of access to finance. In doing so, the chapter will explain why small businesses need to be protected, their weak bargaining positions, issues of information asymmetry and monitoring, and more philosophically, their role in social renewal and improvement of social well-being. While the analysis will focus on the vulnerability of small businesses, it is axiomatic that lenders also have vulnerabilities in their dealings with small businesses and these will be flagged up as brief comparisons during the analysis. Conclusions will summarise the arguments.

1. What is a small business?

It is crucial to define ‘*small business*’. Small and Medium sized Enterprise (SME) and small business are terms which are interchangeably used in policy discussion and debates to distinguish them from large firms. The importance of defining ‘*small business*’ lies in the fact that once an enterprise is classified as a ‘small business’, it benefits from specific policies and

programmes geared towards small businesses. A small business also qualifies for government assistance, state aid or loans (for example, in the UK through 'Funding for Lending' scheme), which are not generally available to large firms or companies that can borrow widely on a secured or unsecured basis from banks. However, surprisingly, there is no universal definition of a small business. The difficulty with providing a universal definition of small businesses can be attributed to a number of factors. Every economy has different levels of development. While it is understandable that international organisations' definition of small business works for their aim at providing financial support to underprivileged areas and sectors (as small businesses in those economies are relatively much more small or modest in size and turnover), the same definition generally does not suit the domestic markets of economically developed nations. In addition to the annual turnover and the number of employees, the business culture, the business sector that they operate in and the economic contribution of the SME in its home market are altogether decisive factors as to what should be defined as an SME.¹³

The EU has redefined¹⁴ the scope of definition of small businesses in order to cover them under single terminology.¹⁵ Article 2 paragraph 1 of the Recommendation defines SMEs as follows:¹⁶

'enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.'

¹³ An independent formula for defining SMEs has been provided as follows: "An SME is a formal enterprise with annual turnover, in U.S. dollar terms, of between 10 and 1000 times the *mean* per capita gross national income, at *purchasing power parity*, of the country in which it operates." See T. Gibson and H.J. Van Der Vaart, 'Defining SMEs: A Less Imperfect Way of Defining Small and Medium Sized Enterprises in Developing Countries' *Brookings Global Economy and Development* (September 2008).

¹⁴For the introduction of a new definition of SME in the European Union see http://ec.europa.eu/enterprise/enterprise_policy/sme_definition/sme_user_guide.pdf (last visited 5 September 2015).

¹⁵ For the significance of SMEs in European Contract Law see M. W. Hesselink, 'SMEs in European Contract Law' Briefing Note, Directorate General Internal Policies, Policy Department C Citizens Rights and Constitutional Affairs (IP/C/Juri/FWC/2007-211; PE378.300, June 2007).

¹⁶ Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, *Official Journal* L 124, p. 36-41, of 20 May 2003. The first definition of SME was adopted in 1996 by the European Commission. Commission Recommendation 96/280/EC of 3 April 1996 concerning the definition of small and medium-sized enterprises, *Official Journal* L 107, p. 4-9, of 30 April 1996.

According to this definition number of employees and either turnover or balance sheet total are the two decisive factors in determining whether a company is qualified to be an SME. The European Commission's "*The New SME Definition User Guide and Model Declaration*" discusses the grounds for adopting a new definition. These grounds aim at mitigating small businesses' vulnerability to market changes. These grounds include: update of staff and financial thresholds to enable small businesses to retain their SME status; promotion of micro enterprises; improving access to capital by facilitating equity capital through government schemes, regional funds and venture capital companies; promotion of innovation and access to research and development; and to prevent abuse of small business status. This new definition may help small businesses to be considered as companies, which may assist them to obtain financing in the company level rather than partners' personal creditworthiness.¹⁷

Under the International Finance Corporation (IFC) frame SMEs are defined 'as registered businesses with less than 300 employees.'¹⁸ While the IFC definition is quite basic, the working definition also indicates that the total annual sales or assets of an SME should not be more than \$15 million.¹⁹ While in the United Kingdom, in the early 1970s, the Bolton Committee²⁰ attempted to define small firms, the definition received criticism for being

¹⁷ 'An Action Plan to improve access to finance for SMEs' {SEC(2011)1427 final} COM (2011) 870 Final; "Framework for the next generation of innovative financial instruments – the EU Equity and Debt Platforms" COM (2011) 662. A recent study in 2012 showed that there was no need for a major revision of the SME definition. See 'Final Report on Evaluation of the SME Definition' (September 2012) available at http://ec.europa.eu/enterprise/policies/sme/files/studies/evaluation-sme-definition_en.pdf (last visited November 2013)

¹⁸ 'Interpretation Note on Small and Medium Sized Enterprises and Environmental and Social Risk Management' International Finance Corporation (1 January 2012), 1 available at http://www.ifc.org/wps/wcm/connect/de7d92804a29ffe9ae04af8969adcc27/InterpretationNote_SME_2012.pdf?MOD=AJPERES (last visited 20 November 2015). But cf 'SMEs Small and Medium Enterprises' *Telling Our Story*, volume 5, issue 1 (International Finance Corporation, 2011) p. 3 where SMEs were defined as registered businesses with less than 250 employees.

¹⁹ n. 18 above, Interpretation note, 1.

²⁰ J.E. Bolton, 'Report of the Committee of Enquiry on small firms' *Bolton Report* (Cmnd. 4811) (London: HMSO, 1971). The definition suggested that small businesses had small share in the market, managed by owners, and were independent. Additionally, the Report qualified the definition by suggesting its economic contribution over time, its size and contribution to sectors and its comparison to other countries' small firms. The definition was used in a number of surveys in the 1970s. see e.g. Committee to Review the Functioning of Financial Institutions 'Studies of Small Firms Financing Research Report No. 3' (London, 1979).

complex.²¹ Under section 382(3) of the Companies Act 2006, a company qualifies to be a small company if two or more of the following conditions are met: its turnover is not more than £6.5 million; its balance sheet total is not more than £3.26 million; its number of employees is not more than 50. Additionally, according to the section 465(3) of the Companies Act 2006, a company qualifies to be a medium sized company if two or more of the following conditions are met: its annual turnover is £25.9 million or less; the balance sheet is £12.9 or less; the number of employees is 250 or less. Nevertheless, the definition of a small and medium sized enterprise in the UK adopted by the Department of Business Innovation and Skills (DBIS), in which the number of employees is the decisive factor, seems to define an SME as a business with fewer than 250 employees (0-249 employees).²² In the United States, a firm is an SME if it has fewer than 500 employees. It must be noted, however, different revenue indicators are applicable for different sectors.²³ By comparison, in Australia a small business is a business employing fewer than 15 employees.²⁴

²¹ The definition provided by the Bolton Committee was criticised on the grounds that the monetary indicators used in the definition are prone to change over time due to currency fluctuations, different criteria for different sectors make the definition unnecessarily complex. *See generally* D. Storey, *Understanding the Small Business Sector* (London: International Thomson Business Press, 1994).

²² This is the definition adopted by the Department for Business, Innovation and Skills *see* ‘Business Population Estimates for the UK and Regions 2013’ Department for Business, Innovation and Skills (2013). There is also a definition prepared by the Law Commission to deal with non-negotiated unfair contract terms with small businesses. Section 27 of the draft Bill defines a “small business” as follows:

‘(1) “Small business” means a person in whose business the number of employees does not exceed (a) nine, or (b) where the Secretary of State specifies by order another number for the purposes of this section, that number. (2) But a person is not a small business if adding the number of employees in his business to the number of employees in any other business of his, or in any business of an associated person, gives a total exceeding the number which for the time being applies for the purposes of subsection (1). (...)’.

see The Law Commission and the Scottish Law Commission (Law Com No. 292) (Scot Law Com No. 199) ‘Unfair Terms in Contracts Report on a Reference under Section 3(1)(e) of the Law Commissions Act 1965’ (Cm 6464, 2005).

²³ *See* ‘Small and Medium-Sized Enterprise: Overview of participation in US Exports’ *United States International Trade Commission* Investigation No. 332-508 (USITC Publication no. 4125, January 2010), 1-3. Revenue threshold does not apply to manufacturing and non-export services firms but for Exporting Services firms the threshold revenue is \$7 to \$25 million. For farms it is \$250,000. *see also* <http://www.sba.gov/content/summary-size-standards-industry> (last visited 20 September 2014).

²⁴ Fair Work Act 2009, s. 23.

Thus, it can be argued that a simple, straightforward small business definition is not possible. Definitions differ according to the size and the strength of the economy of a country, the significance of the business sector and the contribution of the small business to that economy. For the purposes of the analysis here a small business is not defined by any absolute threshold in terms of turnover or employment but relatively as a firm small in staff and revenue compared to its product competitors with the future potential to contribute to job creation, economic growth and export, and maintains social renewal and mobility in the society, but vulnerable to the withdrawal of external finance in a downturn. These types of organisations can be either partnerships or small companies engaged in export and import or manufacturing.

2. Defining ‘vulnerability’

The word ‘vulnerable’ is defined as something ‘that may be wounded; susceptible to injury, exposed to damage by weapon, criticism, etc.’²⁵ Robert Goodin suggests that “‘vulnerability’ is essentially a matter of being under the threat of harm [and] protecting the vulnerable is primarily a matter of forestalling threatened harms.”²⁶ Arguably, the ‘susceptibility to injury’ can be further extended in the context of SMEs to damages caused by the inability to access to financial markets, external finance or raise finance in general to increase resources to be able to survive in the face of market volatilities and financial crisis. The damage caused by the inability to access to finance may include going bankrupt or out of business, not being able to expand resources or business (while it is accepted that not all businesses would prefer to expand business but rather prefer to stay as small businesses) and on a more general basis, not being able to create employment.

Vulnerability within the context of small businesses’ access to finance may be defined as inability to borrow or expand business, or in the general perspective, continue to trade. It is clear that small businesses lack both power and entitlements,²⁷ which makes them vulnerable compared to financial institutions and larger firms. In that context, the effects of SMEs’ limited or no access to finance and their inability to join in or influence effectively the

²⁵ The Oxford Concise Dictionary, 1205 (Oxford, 7th ed., 1983).

²⁶ R.E. Goodin, *Protecting the Vulnerable A Reanalysis of our Social Responsibilities*, 110 (Chicago and London: The University Chicago Press, 1985).

²⁷ For reasons of poverty and lack of entitlements see I. Christoplos and J. Farrington, ‘The Issues’ in I. Christoplos and J. Farrington (eds) *Poverty, Vulnerability, and Agricultural Extension*, 1, 3 (Oxford: Oxford University Press, 2004).

decision making process in terms of growth policies expose two specific areas of vulnerability. These are loss of business and loss of opportunity to efficiently influence socio-economic policies. The former includes two particular points. Firstly, the loss may be internal, revealing problems of financing and insolvency issues. Secondly, it may be external, revealing problems of expansion for further investment. The latter directly influences concepts such as social renewal, social mobility and social cohesion.²⁸

3. Why are small businesses important?

The answer to this question depends on factors such as how developed the economy of that home market, how the home market perceives the SME's sector, and how crucial is the type of sector in which the SME is operating to the economy of the home market.

It can be argued that globally SMEs are key players in the economic development and innovation.²⁹ They have impact on job creation,³⁰ income³¹ and growth in all economies.³² They have also become internationalised due to their export of goods and services to overseas markets. The performance of SMEs has also been linked to the macro-economic

²⁸ For the significant numbers of SMEs *see* nn. 7 and 8 above.

²⁹ K. Morgan, 'The Learning Region: Institutions, Innovation and regional renewal' (1997) 31 *Regional Studies* 491, 492 *et seq.*

³⁰ SMEs contribute to 67 per cent of the full time and permanent employment worldwide and 85 per cent to net employment growth. For SMEs contribution to job creation *see e.g.* J. De Kok, P. Vroonhof, W. Verhoeven, N. Timmermans, T. Kwaak, J. Snijders, F. Westhof 'Do SMEs create more and better jobs?' (EIM Business and Policy Research, November 2011); M. Ayyagari, A. Demirgüç-Kunt and V. Maksimovic, 'Small vs. Young Firms Across The World – Contribution to Employment, Job Creation, and Growth', Policy Research Working Paper 5631 (The World Bank Development Research Group, 2011).

³¹ According to studies SMEs contribute significantly to GDP between 15 per cent in low income countries to more than 50 per cent in high income countries. *see e.g.* M. Ayyagari, T. Beck and A. Demirguc-Kunt, 'Small and Medium Enterprises Across the Globe' (2005) available at http://siteresources.worldbank.org/DEC/Resources/84797-1114437274304/SME_globe.pdf (last visited 5 September 2015).

³² For more on these matters and the work of the International Finance Corporation (IFC) *generally see e.g.* 'SMEs Small and Medium Enterprises' *Telling Our Story*, volume 5, issue 1 (International Finance Corporation, 2011). *See also generally* 'The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses', (OECD Publishing, 2009). *See* <http://www.fsb.org.uk/stats> (last visited 5 September 2015). According to the Federation of Small Business statistics (figures obtained from the Department of Business Innovation and Skills), at the start of 2013 in the UK there were 4.9 million small businesses employing 24.3 million people and small businesses accounted for 59.3 per cent of private sector employment.

performance of EU member states.³³ For all those reasons, SMEs have been widely publicised as the “engines for growth”. It has also been argued that small businesses are instrumental in maintaining social mobility, social cohesion and social justice.³⁴ Social mobility occurs when the members of society move between different socio-economic layers in the society as a result of obtaining better legal, economic and political rights. It is argued that small businesses assist the process of social mobility by providing employment, entrepreneurship and business ownership and opportunities. Further, the creation of more SMEs may also assist social justice by closing gender inequality (by providing opportunities for entrepreneurship) and financing gap caused by the financial crisis.³⁵

4. Vulnerability and Resilience

In the aftermath of the financial crisis, small businesses have shown both *vulnerability* and *resilience* to the effects of the crisis. Their vulnerability is a result of ‘intrinsic weaknesses of [small businesses] in facing external shocks’.³⁶ These weaknesses may be exemplified, from a corporate governance perspective, as weak knowledge of business or financial skills and lack of managerial skills that may be decisive during times of crisis. Smallbone *et al.* define vulnerability of small businesses as being ‘highly susceptible to external shocks such as recession because of a number of size-related characteristics.’³⁷ These include limited internal resources compared to larger firms, limited line of products and customer base and less bargaining power³⁸ as well as the tendency to, mainly, rely on the bank credit rather than

³³ See C. Guglielmetti, ‘Introduction’ in B. Dallago and C. Guglielmetti (eds) *The Consequences of the International Crisis for European SMEs* (Abingdon: Routledge, 2012), 1.

³⁴ See ‘Strengthening Access to Finance for Women-Owned SMEs in Developing Countries’ International Finance Corporation (October 2011); ‘Removing Barriers to Economic Inclusion Measuring Gender Parity in 141 Countries’ Women, Business and the Law, The World Bank and the International Finance Corporation (2012); Grant Shapps, ‘Small businesses can lead Britain back to prosperity’, *The Guardian*, 28 December 2013.

³⁵ n. 34 above, ‘Strengthening Access to Finance for Women-Owned SMEs in Developing Countries’ where it is noted ‘... because financing is an important means by which to pursue growth opportunities, addressing women entrepreneurs’ specific needs in accessing finance must be part of the development agenda.’, 6.

³⁶ C. Guglielmetti, above note 33, 13 and generally chapter 5 by D. Smallbone, J. Kitching and M. Xheneti, ‘Vulnerable or Resilient? SMEs and the Economic Crisis in the UK’ in B. Dallago and C. Guglielmetti (eds) *The Consequences of the International Crisis for European SMEs*, 109 *et seq.*

³⁷ D. Smallbone, D. Deakins, M. Battisti and J. Kitching, ‘Small Business responses to a major economic downturn: Empirical perspectives from New Zealand and the United Kingdom’ (2012) 30 *International Small Business Journal* 754, 760.

³⁸ Smallbone *et al.* n. 37 above, 760.

other financing patterns. Some small businesses have also shown ‘*resilience*’³⁹ which reflects the small businesses’ ‘flexibility and capacity to adjust to external circumstances’.⁴⁰ Resilience, thus, suggests the ability to adjust or adapt to market volatilities or recover fast from the effects of systemic failure of financial markets. In the context of access to finance, for a small business, resilience may mean the existence of alternative financing arrangements (be it retained profits or non-bank financing) other than bank credit (which may be sparse at times of financial crisis) and the ability to obtain finance which enable the small business to continue its trading. Adaptation seems to be the crucial point when it comes to possible legal and financial reactions to the predicted global financial and economic crisis.

The volatility of markets as well as the impact of deregulation on access to finance have encouraged general wariness and led to market failure. Countering this problem might be described as a form of social renewal, at least in contexts where people have been, historically, pro-market. It is fair to say that law is ‘a vehicle for social change’.⁴¹ Its responsiveness to social and business needs is necessary. Nonet and Selznick note that ‘[a responsive law] perceives social pressures as sources of knowledge and opportunities for self-correction’.⁴² In the wake of the financial crisis, small businesses’ vulnerability to access to finance and changes in the market is evident. In this context, while it may be regarded as a matter of contractual freedom, arguably, the law, by being responsive to social changes, should protect the vulnerable small businesses against the stronger lenders with better bargaining positions.⁴³ Similar arguments can be made in favour of lenders who are disadvantaged in their dealings with small businesses due to the asymmetric information. The use and availability of collateral or clear information about the financial strength of the borrower (i.e. small business) encourages lending and reduces the financial vulnerability of lenders.⁴⁴

³⁹ ‘Resilience’, in the context of small businesses and access to finance, is defined as ‘the process of adapting well in the face of adversity and the survivability of SMEs during recession...’ see L. Price, D. Rae and V. Cini ‘SME perceptions of and responses to the recession’ (2013) 20(3) *Journal of Small Business and Enterprise Development* 484, 485.

⁴⁰ See Dallago and Guglielmetti (eds), n. 33 above, 13 and generally chapter 5.

⁴¹ R. Wacks, *Philosophy of Law: A Very Short Introduction*, (Oxford: Oxford University Press, 2006), xii.

⁴² P. Nonet and P. Selznick, *Law and Society in Transition Toward Responsive Law* (New York: Harper Torchbooks, 1954), 77.

⁴³ See below for further arguments on bargain and contract.

⁴⁴ B. Carruthers and L. Ariovich, *Money and Credit A Sociological Approach* (Cambridge: Polity Press, 2010) 90. This is particularly true in the case of investment crowdfunding.

5. Some philosophical perspectives

Rule of law has been regarded as the cause of a just society as well as growth.⁴⁵ It has been argued that rule of law, and clearly defined and enforceable property rights are conditions of economic growth which complements societal development.⁴⁶ Economic growth (development) has been defined by Joseph Schumpeter as follows:

Development in our sense is a distinct phenomenon, entirely foreign to what may be observed in the circular flow or in the tendency to equilibrium. It is spontaneous and discontinuous change in the channels of the flow, disturbance of equilibrium, which forever alters and displaces the equilibrium state previously existing.⁴⁷

Economic development/growth is a type of progress which occurs through the collective efforts of individuals who are entrepreneurs. A Rawlsian view will suggest that for this type of progress, be it economic or socio-legal, there is a need to have a *well-ordered society* which is

designed to advance the good of its members and effectively regulated by a public conception of justice. Thus it is a society in which everyone accepts and knows that the others accept the same principles of justice, and the basic social institutions satisfy and are known to satisfy these principles.⁴⁸

Well-ordered society is part of Rawls's background assumptions and a political conception of justice. Rawls considers the 'idea of society' within the conception of justice 'as a fair system of social cooperation over time from one generation to the next'.⁴⁹ Rawls's central 'idea of society' is supported by the idea of citizens who are considered as free and equal, and the idea of well-ordered society which is 'governed by principles of justice'.⁵⁰ Rawls applies these principles to the 'basic structure' that is the society's political and legal institutions

⁴⁵ T. Bingham, *The Rule of Law*, 38-39 (London: Penguin, 2011) (citing 'Economics and the Rule of Law: Order in the Jungle' *The Economist*, 13 March 2008, 95-7)

⁴⁶ D.C. North, 'The Paradox of the West', 1, available at <http://www.archipielagolibertad.org/upload/files/007%20Estado%20de%20derecho/7.1%20Derecho,%20ley,%20instituciones/0025%20North-%20The%20paradox%20of%20the%20west.pdf> (last visited 15 September 2015)

⁴⁷ J. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest and the Business Cycle*, (translated by Redvers Opie, Oxford University Press, 1961), 64 (1934)

⁴⁸ J. Rawls, *A Theory of Justice* (Oxford: Oxford University Press, 1978), 453-454

⁴⁹ J. Rawls, *Justice as Fairness: A Restatement*, (Cambridge: Harvard University Press, 2001), 5.

⁵⁰ Rawls, n. 49 above, 5.

which are governed by principles of justice.⁵¹ In the well-ordered society institutions prevent vulnerabilities through principles of justice. As a result ‘reciprocity’ and ‘a social minimum of primary goods’ are secured. It has been argued that ‘[i]t is not crucial that all citizens have equal economic wealth, but it is important that citizens have a sufficient level of reciprocity.’⁵² Thus, reciprocity is understood as

a relation between citizens expressed by principles of justice that regulate a social world in which all who are engaged in cooperation and do their part as the rules and procedures require are to benefit in an appropriate way as assessed by a suitable benchmark of comparison.⁵³

When this line of thought is applied to vulnerability and access to finance framework, the following may be argued. The *good*, here, can be argued as the increase in income levels, contribution to economic growth and the increase in social mobility and entrepreneurship and closing the gender inequality gap as a result of small businesses’ access to finance. Bank of England’s *Finance for Small Firms* report noted that

[a] strong relationship between small firms and finance providers is an essential ingredient for promoting enterprise and growth. To innovate and expand, small firms depend upon reliable access to external finance. Ensuring that there is efficient intermediation of funds to small firms, based on a good understanding of risks and returns, is thus an important public policy objective.⁵⁴

Justice is a more difficult one to argue as it must create equilibrium for both the lenders and small businesses as borrowers. The position of lenders and small businesses is analogous to a mutual vulnerability and responsibility relationship.⁵⁵ If small businesses are vulnerable to financial crisis and market volatilities, then the State or the individuals who have the responsibility to protect them, need to take steps to prevent small businesses from being negatively affected from financial crisis and market failures. This is based on the idea that small businesses are important to economic growth and job creation. Thus, it is in the interest of the State to protect and enable them to access to finance to achieve the results beneficial for the whole economy. An extrapolation from this argument is that there could be instances

⁵¹ Rawls, n. 49 above, 10.

⁵² T. Brooks, ‘Reciprocity as Mutual Recognition’ (2012) 21 *The Good Society* 21, 26.

⁵³ Rawls, n. 49 above, 49.

⁵⁴ Bank of England, *Finance for Small Firms – An Eleventh Report*, 1 (April 2004).

⁵⁵ For a discussion of system of rights and mutual vulnerability and responsibility see e.g. R. M. Unger, ‘The Critical Legal Studies Movement’ 96 *Harvard L. Rev.* 561, 597 *et seq.* (1983)

when the State might encourage 'strategic forbearance' by lenders. In other words, promoting access to finance for SMEs in a downturn might be accomplished not only through proactive schemes, but also by encouraging banks to re-write existing loan contracts.

Facilitating small businesses' access to finance may create jobs⁵⁶ and this may lead to less dependency on public sector jobs or benefits. Less dependency on public sector jobs and benefits and creation of employment may renew confidence in the markets and the financial system by regenerating the economy of a country.⁵⁷ Small businesses' ability to access to finance and protection from vulnerability to financial crisis and market changes work towards social well-being, financial inclusion and social mobility whereby people improve their socio-economic levels through their entrepreneurship and contribute to the overall growth.⁵⁸ Rising income and confidence in financial markets could have positive impact on social renewal. It may be argued that lenders that are, say under the *Funding for Lending Scheme*, have the responsibility to protect the vulnerable (*i.e.* those small businesses that are in financial difficulty).⁵⁹ Thus, it is important and a public good to support SMEs, as this contributes to economic growth and social renewal. Lenders in this category are being funded

⁵⁶ See n. 30 above.

⁵⁷ Obviously there are other methods to renew confidence in markets and one of them is the ability of 'markets to demonstrate that they are more competent to regulate themselves either collectively or through bilateral contracting arrangements ...' see J. Black, 'Rebuilding the credibility of markets and regulators' (2009) *Law and Financial Markets Review* 1, 2.

⁵⁸ On Social Cohesion see *e.g.* F-B. Wietzke and C. McLeod, 'Jobs, Well-being and social cohesion Evidence from Value and Perception surveys' Background Paper to the 2013 World Development Report (2013) https://openknowledge.worldbank.org/bitstream/handle/10986/12138/WDR2013_bp_Jobs_Wellbeing_SocialCohesion.pdf?sequence=1 (Last visited 5 September 2015) noting that

'... jobs can contribute to social cohesion through their effects on personal wellbeing, identities, and political and social preferences. Individuals who perceive that they are paid fairly and not disadvantaged in their search for jobs are less likely to disengage from the political and social institutions of their communities. Likewise, workers who feel that their job prospects depend at least partially on the overall performance of a nation's economy may sense a vested interest in the political and economic institutions of their country. This interdependence of interest can align personal with societal preferences and contribute to a stronger sense of national identity and fewer conflicts within the labor market.', 2.

⁵⁹ See *e.g.* 29 November 2013 dated letter to CEOs on the 'Treatment of small and Medium sized enterprise (SME) customers' from Clive Adamson, Director of Supervision of the Financial Conduct Authority (FCA) available at <http://www.fca.org.uk/static/fca/documents/letter-ceo-tomlinson-report.pdf> (last visited 20 September 2015).

by the State under the scheme so the State has the responsibility towards SMEs that they are funded accordingly. However, lenders have their own vulnerabilities as they are constrained by inter-bank lending and the Basel III Capital Adequacy requirements. From this perspective it is also safe to argue that the State has responsibility towards lenders, too. But these are two strong opposite positions. On one hand, it is important to support (by establishing the necessary infrastructure) and finance SMEs to reduce their vulnerability (a moral good to further their interest) and on the other hand, it is important to protect the interests of lenders in order to make resilient in the face of future financial crisis. Goodin suggests that

[w]hom we should favour depends ... upon the relative vulnerability of each party to us. We must determine: (1) how strongly that party's interests would be affected by our alternative actions and choices; and (2) whether or not he would be able to find other sources of assistance/protection if we failed him.⁶⁰

His argument, which one can concur, is that 'protecting the vulnerable is ... an argument for aiding those in dire need.'⁶¹ From this perspective, it would be safe to argue that failure to protect small businesses would adversely affect their contribution to economic development and social renewal. Following from that it is the external financing that small businesses need most at times of crisis and it is the banks, with the support of the State, that assist small businesses to access credit. Without their assistance at times of recession and financial crisis, it is not possible for small businesses to find alternative sources to contribute to economic growth, job creation and social renewal.

Small businesses' failure has a clear impact over individuals to whom the State has responsibility, too. This can be posited as the responsibility of the State to establish a financial and legal framework which understands the barriers to access to finance, and either addresses those barriers or enables small businesses to negotiate them. In terms of individual vulnerability it has been argued that

...consideration of vulnerability brings societal institutions, in addition to the state and individual, into the discussion and under scrutiny. Vulnerability is posited as the characteristic that positions us in relation to each other as human beings and also suggests a relationship of responsibility between state and individual. The nature of human vulnerability forms the basis for a claim that the state must be more responsive to that vulnerability. It fulfils that responsibility primarily through the establishment and support of societal institutions.⁶²

⁶⁰ Goodin, n. 26 above, 119.

⁶¹ Goodin, n. 26 above, 111.

⁶² M. Fineman, 'The Vulnerable subject and the Responsive State' 60 *Emory Law J.* 251, 255-256 (2010).

The responsibility of the State is to protect small businesses and to prevent their failure. When the role of small businesses in economic growth is taken into account, the duty of the State to protect the vulnerable small businesses will have an impact on the macroeconomic level. Their protection and prevention from becoming bankrupt will have positive impact on the social level as well. Therefore, it can be argued that the State has both a positive duty (i.e. to take preventive measures to protect businesses from the effect of financial crisis and market changes) and a negative duty (i.e. not to take decisions that may lead to the bankruptcy of small businesses which may cause failure of the economy).⁶³ The positive and negative duties can be both compiled under a concept of ‘pragmatic duty’ of the State. It may be argued that as small businesses account for over 90 per cent of the world economy there seems to be a relation of mutual reliance between the State and the small business sector⁶⁴ and that it is sensible for the State to protect the vulnerable party from incurring further loss.

6. Some responses to reduce vulnerability to access to funding

Financial crises and their ensuing market complications tend to cause a number of problems that affect small businesses access to finance. These include delays in payments to small businesses and lack of demand for goods and services which cause decrease in working capital and liquidity for small businesses to expand business, and the increase in their insolvencies which is an indication of their lack of access to short term finance (such as bank lending).⁶⁵ Particularly, the impact of insolvencies of small businesses as a result of financial crisis, as it is evident that banks’ reluctance to extend long term finance options has led small businesses to obtain short term finance. It can be argued, however, that banks’ perception of small businesses’ ability to repay (whether they are high or low risk debtors), their forecasts as to the aftermath of financial crisis, and the banks’ ability to access to finance (their capital and liquidity positions as required by the Basel Capital Adequacy Requirements and the problems caused by inter-bank lending) can be regarded as decisive factors in banks’ decisions to lend to small businesses. Banks prefer to lend where the debtor can provide full collateral that has the ability to mitigate the effect of debtor’s default. Nevertheless, access to

⁶³ For further discussion on positive and negative duties *see* Goodin, n. 26 above, 22 *et seq.*

⁶⁴ For the relationship between mutual reliance and vulnerability *see* Unger, n. 55 above, 600.

⁶⁵ ‘*The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses*’, (OECD Publishing, 2009), 6-8.

long term finance could enable small businesses to be able to spread their payments to a wider timeframe and avoid defaults.

In the aftermath of the 2008 financial crisis, steps have been taken to deal with the above highlighted challenges by introducing, for example, the Enterprise Finance Guarantee Scheme (EFG). This loan guarantee scheme which is now run by the British Business Bank⁶⁶ '[is] delivered via participating Lenders and aimed at supporting the availability of working capital and investment funding for small and medium sized businesses in the UK.'⁶⁷ Moreover, the Bank of England's introduction of Funding for Lending Scheme (FLS) in July 2012 is aimed to reduce the financial vulnerabilities of small businesses. This scheme intends to promote lending to small business by banks and building societies who borrow from the Bank of England at relatively lower rates than market rates. The FLS has been extended for a further two years on 30 November 2015.⁶⁸ However, while credit conditions have improved with the introduction of the FLS, same cannot be argued for SMEs the credit supply to which has been low.⁶⁹ It can be argued that banks which have been de-mutualised have social duties to lend to small businesses.⁷⁰ While, from the perspective of banks, the relationship between banks and small businesses can be regarded as a private one (as bargain and contract), through the Funding for Lending Scheme, it is argued, this becomes a regulated contractual relationship. The understanding under the Funding for Lending scheme is to facilitate lending to small businesses whereby the banks and building societies are funded for an extended

⁶⁶ <http://british-business-bank.co.uk/ourpartners/enterprise-finance-guarantee/> (last visited 20 November 2015).

⁶⁷ <http://www.fsb.org.uk/policy/assets/efg.pdf> (last visited 20 September 2015). For the list of participating lenders see <http://www.berr.gov.uk/whatwedo/enterprise/finance/efg/page50162.html>. Small businesses in their Principles of Small Business Banking requested that all banks dealing with small businesses should apply for European Investment Bank Credit, along with the Enterprise Finance Guarantee Scheme. See <http://www.fsb.org.uk/documents/bankingprinciples/> (last visited 20 January 2014).

⁶⁸ <http://www.bankofengland.co.uk/publications/Pages/news/2015/096.aspx> (last visited 1 December 2015)

⁶⁹ Bank of England and HM Treasury Funding for Lending Scheme -2015 Q3 Usage and Lending Data, News Release 2 December 2013 See <http://www.bankofengland.co.uk/publications/Pages/fls/q315.aspx> (last visited 8 December 2015) where it is stated that the "[i]mprovements in credit conditions over the past few years in part reflect developments in bank funding spreads; despite a slight rise in some measures over the past few months, they remain significantly lower than at the time of the launch of the FLS in 2012."

⁷⁰ e.g. Sir Andrew Large, 'RBS Independent Lending Review' (25 November 2013) http://www.independentlendingreview.co.uk/RBS_ILR_Full_Report.pdf (last visited 15 September 2015); Lawrence Tomlinson, 'Banks' Lending Practices Treatment of Businesses in Distress' <http://tomlinsonreport.com/docs/tomlinsonReport.pdf> (last visited 15 September 2015)

period by the Bank of England in line with their lending performance.⁷¹ The argument then follows that the State then has the responsibility to make sure that the SMEs are funded accordingly in order to be able to contribute to the economy. The United Kingdom Government's *Plan for Growth*⁷² document provided a number of strategies that would assist small businesses' access to finance and contribution to economic growth.⁷³ Alternative financing platforms, which act as intermediaries between investors and small businesses, facilitate opportunities of funding. As an example, the *Funding Circle*⁷⁴ is part of the United Kingdom Government's Business Finance Partnership scheme and has been operating since 2010. Lending under the Funding Circle or similar alternative financing platforms eliminates intermediaries and allows small businesses to borrow directly from investors where the lender spreads the risk by lending to multiple creditworthy borrowers and the borrower borrows from multiple lenders to obtain a low interest rate. The types of funding relevant are either loan-based crowdfunding (loans) or investment-based crowdfunding (equity based).

Private law also offers a number of solutions to small businesses' problems in access to funding. These can be particularly found in the law of secured transactions. Firstly, Small Business, Enterprise and Employment Act 2015 s. 1 (Business Contract Terms (Restrictions on Assignment of Receivables) Regulations 2015) nullifies clauses that ban assignment of receivables. Overriding non-assignment clauses enables the effectiveness of assignments made notwithstanding a non-assignment clause. This legislative intervention will provide an option for SMEs to use invoice discounting and factoring financing methods. It is submitted that due to the weak bargaining powers of small businesses (compared to large businesses and banks), it does not seem possible to enable this nullification via contractual methods. Thus, it is necessary to regulate this field via legislative intervention. The significant advantage of factoring and invoice factoring is that receivables owed to the small business are sold (outright assignment) to a factoring company. The factoring company pays a discounted amount in return, rather than collateralizing these receivables. In other words, in

⁷¹ <http://www.bankofengland.co.uk/markets/Pages/FLS/default.aspx> (last visited September 2015)

⁷² 'The Plan for Growth' Department for Business Innovation and Skills (HM Treasury, March 2011).

⁷³ These include minimisation of regulatory burden; assist small businesses to access to finance; reduce fixed costs for SMEs; enable SMEs to access to public sector procurement; encourage innovation and exporting; access to apprenticeships, set up new enterprise zones and make it easier for SMEs to get planning consents. see n. 72 above, 26-27.

⁷⁴ <https://www.fundingcircle.com/> (last visited 20 September 2015)

collateralization the financier takes the assets as security to satisfy the claims of creditors. If the receivables are collateralized the title stays with the small business and in the case of bankruptcy, receivables will become part of the bankrupt small business' estate. The credit risk, thus, stays with the small business. This is a significant point in the decision of credit supplied by the factoring company which is based on the value of the small business' receivable rather than the creditworthiness of the small business.⁷⁵ This is also the case with many international legislative instruments including the United Nations Convention on the Assignment of Receivables in International Trade, UNCITRAL Legislative Guide on Secured Transactions and the UNCITRAL draft Model Law on Secured Transactions Law.

A second method is relevant to the priority competition between an asset based financier and an earlier secured creditor who has taken security interests over the present and future assets of the small business. A small business' main collateral, generally, is its receivables. Small businesses borrow on a secured basis unlike large firms that borrow on unsecured basis.⁷⁶ In some cases, where the small business is not in the form of a company it may not be able to grant charge over its inventory. One alternative to bank financing for small business is to utilise asset based financing. This is also called the *purchase money security interest* where the debtor is given value by the asset based financier to acquire rights in or the use of collateral and the value is used for that purpose. Recognising the priority of an asset based financier against a prior security right with an after acquired property clause might enable small businesses to have better access to asset based finance. That is to say that enabling businesses to have access to competing financing options is said to reduce the cost of credit.⁷⁷ The issue arises when a small business borrows from a lender who takes a charge over the present and after acquired property of the small business before an asset based financier lends for the purposes of purchasing a specific property or supplies equipment to the same small business. If the small business is unable to obtain additional financing from the secured

⁷⁵ L. Klapper, 'The Role of Factoring for Financing Small and Medium Enterprises' *World Bank Policy Research Working Paper 3593* (2005); see also O. Akseli, *Vulnerability and Access to Low Cost Credit* in *Consumer Credit, Debt and Investment in Europe* (M. Kenny & J. Devenney (eds)), Cambridge University Press (2012), 4, at 15. See also <http://www.publications.parliament.uk/pa/cm201415/cmpublic/smallbusiness/memo/sb76.htm> (last visited 20 November 2015).

⁷⁶ Law Commission Report on Company Security Interests (Law Com No. 296, 2005), para 1.2.

⁷⁷ See e.g. UNCITRAL Legislative Guide on Secured Transactions paragraph 52, at 20 which states that "Open competition among all potential credit providers is an effective way of reducing the cost of credit."

creditor, a priority conflict may occur. The general rule under English law, although there are exceptions, on priorities between non-possessory security interests is that the security interests created first in time obtains priority.⁷⁸ Whereas if the super-priority position of the asset based financier were recognised, the priority would be based on the type of the security right rather than the time of registration. Unless a subordination agreement is agreed upon between the secured creditor and the asset based financier, the latter might not be willing to extend credit. This could be, particularly, a problem for small businesses that are new to the market (thus, have no credible credit history and presenting information asymmetry problems) or too small to be able to provide additional collateral. For this reason, it could assist small business to have access to competing financiers, if the super-priority position of the asset based financier was recognised. Previous law reform initiatives on secured transactions law have offered justifications that the asset based financier should be granted a super-priority status.⁷⁹ A super-priority position is offered to the asset based financier under Uniform Commercial Code Article 9-324 as well as under the UNCITRAL Legislative Guide on Secured Transactions recommendations 178-180.⁸⁰

A third method might be to enable non-bank lenders to have better access to the credit history of small businesses. This will perhaps enable non-bank lenders to better evaluate the creditworthiness of a particular small business. Lenders share data among themselves about the borrower's credit information. However, this information is not readily available to non-bank lenders. Having clear information about the creditworthiness of the borrower enables lenders to make better informed lending decisions. This will also mitigate the risks of information asymmetry and increase competition among lenders.⁸¹ One way to enable transparency particularly related to unincorporated businesses is to remove barriers presented by the Bills of Sale Acts (the Bills of Sale Act 1878 and the 1882 Amendment Act). The registration under the current regime is not electronic. The registration system needs to be transparent and accessible by third parties. The Bills of Sale Acts exclude incorporated businesses from its scope as security interests over the assets of these are registrable under

⁷⁸ See H. Beale, M. Bridge, L. Gullifer, E. Lomnicka *The Law of Security and Title-Based Financing*, 464 *et seq.* (OUP, 2nd ed., 2012).

⁷⁹ See e.g. The Law Commission, *Registration of Security Interests: Company Charges and Property other than Land A Consultation Paper* No.164, para 4.159 (2004).

⁸⁰ Para. 123, at 352.

⁸¹ See Bank of England "Should the availability of credit data be improved?" A Discussion Paper, May 2014, p. 5.

the Companies Act 2006 part 25. Thus only individuals and ordinary partnerships are covered by the Bills of Sale Acts. However, the secured transactions law should be comprehensive and include all business and individuals under one comprehensive legislation and registration scheme.⁸² This would enable a transparent and fully electronic system which provides notice to third parties (and *inter alia*, non-bank lenders) about the credit information of the small businesses which are unincorporated. There is currently a limited Bills of Sale Act reform initiative.⁸³ However, the initiative does not intend to establish a notice filing registration system. It just rather seeks to simplify the current registration requirements with the High Court. While there are justified legitimate reasons (such as the need to harmonise law reform initiatives with the Secured Transactions Law Reform project and the City of London Law Society draft Code on Secured Transactions) not to embark upon or suggest a notice filing system, it would have been better, had there been a comprehensive contribution by making clear recommendations on the discussion on this matter. Nevertheless, the Reform on this front will enable small businesses whose wealth mainly lies in goods to have simplified procedures to employ the Bills of Sale Act rather than resorting to unsecured borrowing.

7. Conclusions

The preceding paragraphs have argued that small businesses are vulnerable to financial crisis and market changes. Their vulnerability is linked to their difficulty in access to external finance mainly through commercial loans (bank loans). The protection of small businesses will produce consequences that are for the benefit of the whole economy. Failing to protect them during crisis times may be interpreted as failing to promote economic welfare as small businesses are crucial to economic growth.⁸⁴ Economic growth is generated by the banking system's ability to produce money through leverage and financing of businesses.⁸⁵

It can be argued that there are a number of methods to address the problem of small business' limited access to finance as discussed in this chapter. One these methods can be found within the private law processes offered by secured transactions law. These are, firstly, nullifying clauses that ban assignment of receivables to the extent these prevent small

⁸² See e.g. The UNCITRAL Legislative Guide on Secured Transactions applies to all individuals and businesses. Para. 50, at 20 which states that "... the law should apply to all types of debtor (that is, legal and natural persons, including consumers)."

⁸³ <http://www.lawcom.gov.uk/project/bills-of-sale/> (last visited 20 November 2015).

⁸⁴ Goodin suggests that "[t]he point of protecting the vulnerable is ... that in doing so we produce good consequences (i.e., promote the welfare of the vulnerable people we are protecting)." n. 26 above, 14.

⁸⁵ D. Bholat, 'Money, Bank Debt and Business Cycles: Between economic development and financial crises' in NO Akseli (ed.) *Availability of Credit and Secured Transactions in a Time of Crisis* (Cambridge: Cambridge University Press, 2013), 11, 16 *et seq.*

business' access to factoring and invoice discounting practices. This has been effectively achieved by the Small Business Enterprise and Employment Act 2015 s. 1. Secondly, as part of the general reform activities of secured transactions law, the law could offer super-priority position to the later in time asset based financier against the earlier security interest holder with an after acquired property clause. Thirdly, in order to prevent the effects of information asymmetry security interests over unincorporated businesses should be registrable. This would also eliminate the need to incorporate to access to finance.

Another method can be found in the regulation of alternative finance practices. Particularly, investment-crowdfunding needs to be tightly regulated in order to prevent the effects of information asymmetry. Protecting investors by increasing transparency in the information offered by small businesses will increase investor confidence and eliminate the effects of information asymmetry.

Finally, it can be posited that supporting and protecting the vulnerable leads to greater resilience in the future. Resilience may be achieved at both socio-economic (positive social renewal, better life conditions, social mobility and cohesion, sustainable economic growth) and legal levels (ability of small businesses' access to finance on a systematic basis, ability to absorb financial shocks and less insolvencies).